

ORDER NO. 2242

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman; and
Robert G. Taub

Competitive Product Prices
Parcel Select
Parcel Select Contract 8

Docket No. MC2015-1

Competitive Product Prices
Parcel Select Contract 8 (MC2015-1)
Negotiated Service Agreement

Docket No. CP2015-3

ORDER ADDING PARCEL SELECT CONTRACT 8
TO THE COMPETITIVE PRODUCT LIST

(Issued November 5, 2014)

I. INTRODUCTION

The Postal Service seeks to add a new product identified as Parcel Select Contract 8 to the competitive product list.¹ For the reasons discussed below, the Commission approves the Request.

¹ Request of the United States Postal Service to Add Parcel Select Contract 8 to Competitive Product List and Notice of Filing (Under Seal) of Unredacted Governors' Decision, Contract, and Supporting Data, October 21, 2014 (Request).

II. BACKGROUND

On October 21, 2014, in accordance with 39 U.S.C. § 3642 and 39 C.F.R. § 3020.30 *et seq.*, the Postal Service filed the Request, along with supporting documents. In the Request, the Postal Service asserts that Parcel Select Contract 8 is a competitive product that establishes rates “not of general applicability” within the meaning of 39 U.S.C. § 3632(b)(3). Request at 1. Among the supporting documents, the Postal Service included a copy of the Governors’ Decision authorizing the product, a contract related to the proposed new product, requested changes to the competitive product list, a statement supporting the Request, a certification of compliance with 39 U.S.C. § 3633(a), and financial workpapers. In addition, the Postal Service submitted an application for non-public treatment of materials requesting that redacted portions of the Governors’ Decision and the contract, customer-identifying information, and related financial information remain under seal. Request, Attachment F.²

The contract is intended to take effect one day following the date on which the Commission issues all necessary regulatory approval. Request, Attachment B at 11. It is set to expire three years from the effective date. *Id.*

On October 22, 2014, the Commission issued an order establishing the two dockets, appointing a Public Representative, and providing interested persons with an opportunity to comment.³

² In its application for non-public treatment of materials, the Postal Service asks the Commission to protect customer-identifying information from public disclosure indefinitely. *Id.* at 7. The Commission has consistently denied similar requests for indefinite protection. See, e.g., Docket Nos. MC2011-1 and CP2011-2, Order No. 563, Order Approving Express Mail Contract 9 Negotiated Service Agreement, October 20, 2010, at 6-7.

³ Order No. 2220, Notice and Order Concerning the Addition of Parcel Select Contract 8 to the Competitive Product List, October 22, 2014. The Commission later extended the comment deadline upon a motion from the Public Representative. Order No. 2227, Order Extending Deadline for Comments, October 28, 2014.

On October 24, 2014, Chairman's Information Request No. 1 was issued with several questions filed under seal.⁴ The questions requested clarification of several contract provisions as well as an explanation of how certain costs were factored into the financial model filed under seal. On October 29, 2014, the Postal Service filed its response to CHIR No. 1 and explained the contract provisions at issue, and described how particular costs were contemplated in the financial model.⁵ On October 30, 2014, Chairman's Information Request No. 2 was issued, seeking clarification of how the contract partner's annual volume would be calculated under the contract in light of the Response to CHIR No. 1, question 2.⁶ The Postal Service filed its response on October 31, 2014 and explained that the Postal Service would use the contract partner's prior volume history to calculate the partner's annual volume beginning on January 1, 2015.⁷

III. COMMENTS

The Public Representative filed comments on October 30, 2014.⁸ No other interested person filed comments. The Public Representative reviewed the contract, the Statement of Supporting Justification, the financial data and model filed under seal, and the Response to CHIR No. 1. *Id.* at 2. Based on that review, the Public Representative concludes that Parcel Select Contract 8 should be categorized as a competitive product and added to the competitive product list. *Id.* He also concludes that the contract should generate sufficient revenues to cover costs and satisfy the requirements of 39 U.S.C. § 3633(a) during the first year. *Id.* He notes that the Postal

⁴ Chairman's Information Request No. 1 and Notice of Filing Under Seal, October 24, 2014 (CHIR No. 1).

⁵ Responses of the United States Postal Service to Chairman's Information Request No. 1, with Portions Filed Under Seal, October 29, 2014 (Response to CHIR No. 1).

⁶ Chairman's Information Request No. 2, October 30, 2014.

⁷ Response of the United States Postal Service to Chairman's Information Request No. 2, October 31, 2014 (Response to CHIR No. 2).

⁸ Public Representative Comments on Postal Service Request to Add Parcel Select Contract 8 to Competitive Product List, October 30, 2014 (PR Comments).

Service did not provide data on cost coverage for years 2 and 3 of the contract, but believes risk is mitigated by the contract's annual adjustment provision. *Id.* at 3.

IV. COMMISSION ANALYSIS

The Commission has reviewed the Request, the contract, the supporting data filed under seal, the responses to CHIR Nos. 1 and 2, and the Public Representative's comments.

Product list requirements. The Commission's statutory responsibilities when evaluating the Request include assigning Parcel Select Contract 8 to either the market dominant or competitive product list. See 39 U.S.C. § 3642(b)(1); 39 C.F.R. § 3020.34. Before adding a product to the competitive product list, the Commission must determine that the Postal Service does not exercise sufficient market power that it can effectively set the price of the product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant level of business to other firms offering similar products. See 39 U.S.C. § 3642(b)(1). In addition, the Commission must consider the availability and nature of private sector enterprises engaged in delivering the product, the views of those who use the product, and the likely impact on small business concerns. See 39 U.S.C. § 3642(b)(3); 39 C.F.R. §§ 3020.32(f), (g), and (h).

The Postal Service asserts that it provides postal services of the kind provided under the contract in a highly competitive market, that other shippers who provide similar services constrain its bargaining position, and that it can therefore neither raise prices nor decrease service, quality, or output without risking the loss of business to competitors. Request, Attachment D at 2. The Postal Service states that the contract partner supports the Request, that expedited shipping is widely available from private firms, and that the Postal Service is unaware of any small business concerns that could offer comparable services to the contract partner. *Id.* at 3.

The Commission finds that the Postal Service does not exercise sufficient market power that it can effectively set the price of the proposed product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant level of business to other firms offering similar products. The availability of other private sector providers supports this conclusion. The contract partner and the Public Representative support the addition of the Parcel Select Contract 8 product to the competitive product list. Further, there is no evidence of an adverse impact on small businesses. For these reasons, having considered the relevant statutory and regulatory requirements, the comments filed, and the Postal Service's supporting justification, the Commission finds that Parcel Select Contract 8 is appropriately classified as competitive and is added to the competitive product list.

Cost considerations. Because the Commission finds Parcel Select Contract 8 is a competitive product, the Postal Service must also show that the contract covers its attributable costs, does not cause market dominant products to subsidize competitive products as a whole, and contributes to the Postal Service's institutional costs. 39 U.S.C. § 3633(a); 39 C.F.R. §§ 3015.5 and 3015.7. As long as the revenue generated by the contract exceeds its attributable costs, the contract is unlikely to reduce the contribution of competitive products as a whole or to adversely affect the ability of competitive products as a whole to contribute an appropriate share of institutional costs. In other words, if the contract covers its attributable costs, it is likely to comply with 39 U.S.C. § 3633(a).

Based on a review of the record, the Commission finds that the rates during the first year of the contract should cover the contract's attributable costs. 39 U.S.C. § 3633(a)(2). For this reason, it finds that the contract should not result in competitive products as a whole being subsidized by market dominant products, in accordance with 39 U.S.C. § 3633(a)(1). Similarly, it finds the contract is unlikely to prevent competitive products as a whole from contributing an appropriate share of institutional costs,

consistent with 39 U.S.C. § 3633(a)(3). See also 39 C.F.R. § 3015.7(c). Accordingly, a preliminary review of the contract indicates it is consistent with section 3633(a).

The contract contains a price adjustment provision in Paragraph I.F.1 of the contract that increases contract rates during subsequent contract years by the most recent percentage average increase in prices of general applicability for Parcel Select. Request, Attachment B at 5. The adjustment provision in Paragraph I.F.1 increases the likelihood that rates will cover attributable costs during subsequent contract years. The Commission will review the contract's cost coverage and the contribution of competitive products as a whole to the Postal Service's institutional costs in the Commission's Annual Compliance Determination to ensure that they continue to comply with 39 U.S.C. § 3633(a).

Paragraph I.F.2 of the contract permits the Postal Service to decrease prices at its discretion in conjunction with the annual adjustment described in Paragraph I.F.1. *Id.* Pursuant to 39 U.S.C. § 3632(b)(3) and 39 C.F.R. § 3015.5, the Commission approves the rates filed for future contract years prospectively, effective with the issuance of this Order. The mere inclusion of Paragraph I.F.2 in the contract as filed is not tantamount to pre-approval by the Commission of the elective rates the Postal Service may charge in lieu of rates derived pursuant to the formula set forth in Paragraph I.F.1 of the contract. Rates charged pursuant to the latter paragraph do not require a separate notice filed with the Commission, whereas rates charged pursuant to the former do.

The Commission has previously advised the Postal Service that it must provide notice of rate adjustments made pursuant to the terms of a negotiated service agreement, particularly when such rate adjustments are not determined by "objective, external events."⁹ For example, if contract rates change pursuant to the terms of a

⁹ See, e.g., Docket No. CP2013-65, Order Approving Addition of Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement (with Deutsche Post), June 26, 2013, at 6 (Order No. 1761). See also Docket No. CP2009-29, Order Concerning Filing of Additional Global Direct Contracts Negotiated Service Agreement, May 15, 2009 (Order No. 216); Docket No. CP2009-48, Order No. 384, Order Concerning Change in Prices in Accordance with Order No. 216, January 8, 2010.

particular contract that allows the Postal Service to change rates at its discretion, such discretionary rates must be filed with the Commission no later than 15 days prior to the rate changes' effective date.¹⁰ This will provide the Commission with sufficient time, as contemplated by the statute, to ensure the discretionary rates comport with the requirements of 39 U.S.C. § 3633(a).

The Commission discussed the requirement to provide notice of rate adjustments pursuant to negotiated service agreements in Order Nos. 216 and 1761, and distinguished the levels of review required for discretionary and non-discretionary changes in rates. Consistent with that distinction, the Commission clarifies when the Postal Service is required to give notice of changes in rates pursuant to 39 U.S.C. § 3632(b)(3) for subsequent years of a multi-year contract. If a contract's terms provide for a rate adjustment to be made according to a pre-determined schedule (*e.g.*, at the beginning of a contract year or at the end of every quarter) and a pre-determined formula that is based on objective, external factors, (*e.g.*, changed annually based on the average change in prices of general applicability for that product), the Commission will not require subsequent rate change filings with respect to that contract. The Postal Service will be deemed to have satisfied the notice requirements of section 3632(b)(3) for changes in rates for subsequent years of a contract on the date it initially files the contract provided the rate adjustments under the contract occur on a pre-determined schedule pursuant to a pre-determined formula tied to objective, external events.¹¹ When a subsequent year's rate changes are based on a pre-determined formula tied to objective, external events, the Commission can, in advance, evaluate whether the subsequent year's rates are likely to continue to comply with 39 U.S.C. § 3633. Because the Commission has notice at the time of the initial filing of what the rates are likely to be in subsequent years, the rates for subsequent years can take effect without

¹⁰ Such rate changes should be filed in the Competitive Product docket corresponding to the Commission's initial approval of the agreement.

¹¹ The Commission considers rate adjustments based on changes to published rates to be tied to objective, external events.

additional notice. The Commission's post hoc review of such rates, during the annual compliance review process, provides a means to remedy any deficiency, if necessary. However, rates proposed for subsequent years that are discretionary with the Postal Service, *i.e.*, that are not based on a pre-determined formula that is tied to objective, external events, are not pre-approved and notice must be filed with the Commission at least 15 days before their effective date.

Amendment to the Contract. In Response to CHIR No. 1, question 8, the Postal Service represented that it would file an amendment to correct Table 2a of the contract by making it consistent with Paragraph I.I.1.b of the contract. The correction of Table 2a does not impact the Commission's analysis that the contract satisfies 39 U.S.C. § 3633. The Postal Service shall file the amendment to the contract reflecting the agreement between the parties no later than November 14, 2014. If the amendment contains any terms in addition to or different from the amendment described in the Response to CHIR No. 1, question 8, the Commission will notice the amendment for comment, and review the amendment to determine whether the amended contract continues to fulfill all statutory and regulatory requirements.

Other considerations. The Postal Service states that the instant contract "shall replace the contract that is the subject of Docket Nos. MC2012-34 and CP2012-42." Request at 1. In Order No. 1416, the Commission approved the addition of Parcel Select Contract 5 to the competitive product list.¹² The Commission stated that Parcel Select Contract 5 was scheduled to expire on July 31, 2015 and ordered the Postal Service to promptly notify the Commission if the contract was terminated early. *Id.* at 4. If Parcel Select Contract 5 terminates prior to July 31, 2015, the Postal Service must comply with the requirements described in Order No. 1416.

By its terms, the contract becomes effective one day after the date that the Commission issues all necessary regulatory approvals. Request, Attachment B at 11.

¹² Docket Nos. MC2012-34 and CP2012-34, Order Adding Parcel Select Contract 5 to the Competitive Product List, July 25, 2012 (Order No. 1416).

The contract is scheduled to expire 3 years from the effective date, unless, among other things, it is terminated by mutual agreement in writing or it is renewed by mutual agreement.¹³

The contract also contains a provision that allows the parties to extend the contract for two 90-day periods if a successor agreement is being prepared and the Commission is notified within at least seven days of the contract expiring.¹⁴ During the extension periods, prices will be adjusted as described in the contract. Request, Attachment B at 11. The Commission finds the two potential 90-day extension periods are reasonable because: (1) prices are automatically adjusted in the extension period, making it likely that the contract will continue to cover its attributable costs; and (2) the extension(s) should assist the Postal Service's contract negotiations by providing additional flexibility. If the instant contract is terminated prior to the scheduled expiration date, the Postal Service shall promptly notify the Commission.

Within 30 days after the instant contract terminates, the Postal Service shall file the annual (contract year) costs, volumes, and revenues disaggregated by rate category and weight associated with the contract.

In conclusion, the Commission approves Parcel Select Contract 8 as a new product. The revision to the competitive product list appears below the signature of this Order and is effective immediately.

¹³ *Id.* Should both parties agree to renew the contract, any such renewal is required to follow the requirements of 39 U.S.C. § 3633 and the Commission's implementing regulations of 39 C.F.R. part 3015.

¹⁴ *Id.* As the Commission noted in Order No. 1773, the Postal Service clarified that substantially similar language in Priority Mail Contract 60 contemplates the Postal Service filing any notices of extension with the Commission *at least one week prior to* the expiration of the contract, as opposed to the instant contract's "within at least seven (7) days of the contract's expiration date." See Docket Nos. MC2013-54 and CP2013-70, Order No. 1773, Order Adding Priority Mail Contract 60 to the Competitive Product List, July 8, 2013, at 3; see also Docket Nos. MC2013-54 and CP2013-70, Response of the United States Postal Service to Chairman's Information Request No. 1, July 1, 2013, question 2.

V. ORDERING PARAGRAPHS

It is ordered:

1. Parcel Select Contract 8 (MC2015-1 and CP2015-3) is added to the competitive product list as a new product under Negotiated Service Agreements, Domestic. Revisions to the competitive product list and the Mail Classification Schedule appear below the signature of this Order and are effective immediately.
2. The Postal Service shall file an amendment to the contract no later than November 14, 2014 as discussed in this Order.
3. As discussed in the body of this Order, changes in rates pursuant to a negotiated service agreement that are not made according to a pre-determined schedule and a pre-determined formula based on objective, external factors must be noticed with the Commission filed at least 15 days in advance of the effective date of such rates.
4. The Postal Service shall notify the Commission if the instant contract terminates prior to the scheduled expiration date as discussed in this Order.
5. Within 30 days after the instant contract terminates, the Postal Service shall file the annual (contract year) costs, volumes, and revenues disaggregated by rate category and weight associated with the contract.

6. The Secretary shall arrange for publication in the *Federal Register* of an updated product list reflecting the change made in this Order.

By the Commission.

Shoshana M. Grove
Secretary

CHANGE IN PRODUCT LIST

The following material represents changes to the product list codified in Appendix A to 39 C.F.R. part 3020, subpart A—Mail Classification Schedule. These changes reflect the Commission’s order in Docket Nos. MC2015-1 and CP2015-3. The Commission uses two main conventions when making changes to the product list. New text is underlined. Deleted text is struck through.

Part B—Competitive Products **2000 Competitive Product List**

Negotiated Service Agreements* **Domestic***

Parcel Select Contract 8

CHANGES TO THE MAIL CLASSIFICATION SCHEDULE

The following material represents a change to the Mail Classification Schedule. The Commission uses two main conventions when making changes to the Mail Classification Schedule. New text is underlined. Deleted text is struck through.

Part B—Competitive Products **2000 Competitive Product List**

Negotiated Service Agreements*

Domestic*

Parcel Select Contract 8

2500 Negotiated Service Agreements

2505 Domestic

2505.8 Parcel Select Contracts

- Parcel Select Contract 8

Baseline Reference

Docket Nos. MC2015-1 and CP2015-3

PRC Order No. 2242, November 5, 2014

Included Agreements

CP2015-3, expires November 5, 2017
